Tenet Healthcare (THC) Earnings Report: Q3 2015 Conference Call Transcript

The following Tenet Healthcare conference call took place on November 3, 2015, 10:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Trevor Fetter; Tenet Healthcare; President & CEO
- Daniel Cancelmi; Tenet Healthcare; CFO
- William Wilcox; USPI; CEO
- Britt Reynolds; Tenet Healthcare; President of Hospital Operations

Other Participants

- Ralph Giacobbe; Credit Suisse; Analyst
- Whit Mayo; Robert W. Baird; Analyst
- A.J. Rice; UBS; Analyst
- Sheryl Skolnick; Mizuho Securities; Analyst
- Josh Raskin; Barclays Capital; Analyst
- Kevin Fischbeck; BoA Merrill Lynch; Analyst
- Andrew Schenker; Morgan Stanley; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:
Welcome to the Third Quarter 2015 Tenet Healthcare Earnings conference call.

(Operator Instructions)

Please note the cautionary statement on forward-looking information included in the slides.

I’ll now turn the call over to Trevor Fetter, Tenet’s Chairman and Chief Executive Officer. Mr. Fetter, you may begin, sir.

Trevor Fetter (President & CEO):

Thank you. Good morning, everyone.

I would like to start with the financial highlights of the quarter which are summarized on slide two. We delivered third quarter EBITDA consistent with our guidance range. USPI's results were in line with our expectations and Conifer achieved strong year-over-year growth in both revenue and EBITDA. Our adjusted free cash flow was also very strong in the third quarter and exceeded our expectations.

Compared to the third quarter of 2014, in the third quarter of 2015 we drove an increase of 23% EBITDA and improved our EBITDA margin by 110 basis points. I'm pleased with the way we grew our case mix and high acuity services as well as our performance in pricing growth and cost control. These are all very strong indicators that our strategies to grow the drivers of value are working.

On our second quarter earnings call in August, we discussed our expectations that hospital volume
growth would soften in the third and fourth quarters, relative to the first half of the year. Our record volume growth in the third quarter of 2014 provided us with a very tough comparison. And while our adjusted admissions growth was in line with the guidance we provided, hospital admissions were slightly weaker than we anticipated.

Much of the pressure on in-patient admissions was due to a handful of anomalies by local market specific issues that we’ve been resolving over the past few months. We’re pleased to have achieved increases in higher acuity procedures, largely driven by investments that we have made in key specialty areas. For example, joint replacements are up over 5%, infectious disease surgical cases increased over 15% and neurosurgical cases grew by about 9%. This helped us to generate a 6.5% increase in same hospital revenue growth during the quarter, in spite of the softer volumes.

We achieved solid volume growth in our outpatient facilities. Our ambulatory segment drove a 6.3% increase in volumes and remains on track to deliver strong performance in the fourth quarter. Based on our performance so far this year, and our expectations for the fourth quarter, we are re-confirming the midpoint of our adjusted 2015 EBITDA outlook and narrowing the range. We also are increasing the midpoint of our adjusted free cash flow guidance by $100 million to a new range of $350 million to $500 million.

We remain enthusiastic about Tenet’s opportunities under the Affordable Care Act. The third season of open enrollment kicked off on Sunday and we’re pleased that 90% of Tenet’s hospitals are included in network with the lowest cost Silver Plans on the exchanges. That is the highest percentage we have achieved in the last three enrollment periods. In addition, HHS is focusing enrollment efforts on five cities, including Dallas, Houston, Miami and Chicago, where we generate roughly 20% of our hospital admissions. We are optimistic about 2016 and focused on connecting eligible individuals and families with coverage options.

Turning to slide three, in recent months we have announced several transactions to improve or hospital portfolio and I would like to give you a quick update. We completed our joint ventures in Tucson and Birmingham and our acquisition of the High Desert Medical Center near Palms Springs, California. In total, we invested roughly $300 million in these transactions. We also completed the sale of St. Louis University Hospital at the end of August and expect to finalize the sale of a majority interest in our Fort Dallas hospitals into a joint venture with Baylor Scott and White Health in the fourth quarter.

This morning we announced a definitive agreement to sell our North Carolina hospitals to Duke Lifepoint Healthcare. We also expect to sell our Atlanta hospitals as early as the first quarter of 2016. We expect the divestitures in Dallas, Atlanta and North Carolina to generate roughly $1 billion in cash proceeds.

We expect the cash will be realized at various times over the next six months as individual transactions are completed and receivables from the divested operations are collected. The proceeds may come at times when we have borrowings on our resolving credit line due to the timing of interest payments and seasonal cash out-flows. So as a practical matter, the first use of the incoming cash is to reduce those outstanding borrowings.

I would like now to unto slide four and spend a few minutes discussing how we intend to use the remaining proceeds and how we’re thinking about capital deployment over the next few years. I feel confident about our business strategy and the opportunities for us to create value through organic growth augmented by strategic acquisitions in our business. But when it comes to capital deployment, we need to be flexible and adjust priorities based on the circumstances.

For example, on last quarter’s conference call with our stock in the high $50s, I suggested that one option would be to use the divestiture proceeds to pay down debt, specifically our 8% notes due in 2020
which are callable at 1.04 today for a total of $780 million. The volatility in both the debt and equity markets since then has caused us to re-evaluate and postpone calling those notes and, instead, we’re adding the ability to repurchase sales, the alternative that we have available.

We view share repurchases as an important tool to have in our tool kit. We have a strong track record of buying back shares at low prices, including $1.2 billion in soft buy backs since 2011, at an average price that is well below today's price. We announced yesterday that our Board has approved a new authorization to repurchase up to $500 million of our stock through December 2016.

Taking a big picture perspective on our sources and uses of cash over the next five years, we expect to generate enough free cash flow together with currently available liquidity to fully fund the obligations to our minority partners including the purchase of the rest of USPI.

We expect our first installment payment, which is the only payment in 2016, will be between $125 million and $135 million. We also expect to have sufficient cash to fund a robust program of surgery center acquisitions at USPI while continuing to de-lever through EBITDA growth.

We feel confident in our ability to invest successfully in the growth of our business, increase the view of our company, and, when appropriate, repurchase shares. We have already demonstrated our ability to do so. In 2008 we launched Conifer and created a business that is a market leader today, worth far more than the investment made we made to build this business.

Two years later, we began to invest in outpatient centers that were key to the creation of our joint venture with USPI. We grew a $300 million investment into $900 million in value which we were able to utilize to create the joint venture. We also gained national and regional scale through the Vanguard acquisition and increased the [growth of] our markets in which we're number one and number two in market share.

Our teams have also done a great job identifying and capturing synergies and we built a structural capability to create value in acquired businesses. We are on track to generate over $200 million in synergies from the Vanguard hospitals, exceeding the high end of our original goal of $100 million to $200 million. And with USPI, we have only owned the company for four months but we believe we can extend -- sorry, exceed our target of $50 million in synergies over the next three years.

Moreover, we’re only now beginning to realize the potential of business opportunities that exist between our three business units in solving some of the most pressing problems facing potential health system customers and partners today. We refer to this as a integrated enterprise solution for revenue cycle and value-based care and ambulatory development with joint ownership of acute care assets in selected cases.

It's a powerful offering directed at the 80% of US hospitals in the not-for-profit sector. We’re only in the early stages of conversations with potential partners about this but I think there’s a real potential to create synergies for Tenet by owning all three of our business segments and coordinating these enterprise solutions offerings.

Notwithstanding our capabilities and success in acquisitions, while our equity is at these levels we will narrow our focus. Our first priority with be to acquire surgery centers within USPI. USPI has been able to purchase centers at an average EBITDA less NCI multiple of roughly seven to eight times and reduce the effective multiple to four to five times two years post-acquisition.

At Tenet, we were able to achieve similar economics on outpatient acquisitions. Now, with the synergies between USPI and Tenet, we can create additional near and long-term value for our shareholders by continuing to deploy capital in this way.
As we invest capital in building our ambulatory platform, we will continue to expand our relationships with the not-for-profit health system partners that have been so important to USPI’s success. We have a healthy development pipeline and are pleased that our partners remain enthusiastic about exploring new opportunities to leverage our capabilities. For example, since completing the joint venture, USPI has expanded its relationships with Baylor Scott and White, Memorial Hermann, Dignity Health and Meridian Health, among others.

We will also continue to invest in Conifer to augment its revenue cycle and value based care business line. One of the many benefits of the Tenet-Conifer relationship is the ability for Conifer to develop new services and technologies within Tenet’s hospitals and refine them before they get rolled out to the broader market. This has enabled us to build incremental revenue both within Tenet’s hospitals and for our physicians. Also, Tenet’s portfolio actions not only create new revenue opportunities for Conifer, they also help diversify Conifer’s customer base.

For the time being, we plan to pass on acquisitions of turn-around hospitals requiring large capital investments and defer large investments in projects like newly constructed hospitals and new patient towers.

Turning to our leverage, as recently as two years ago, our ratio of total long-term net to the latest 12 months adjusted EBITDA was 4.7 times. We added leverage to acquire Vanguard, bringing the net leverage ratio up to six times at the end of 2013. Today our net leverage ratio is a little lower.

Even with a $500 million share repurchase, which adds 0.2 turns of leverage, we expect our leverage to be in the high 5s at the ends of 2016 and we’re committed to reducing our leverage by driving improvements in operating results and growing free cash flow.

By the end of 2018, we believe our net leverage to be around five times EBITDA and, absent other capital requirements, we expect it to trend lower after that. The markets may change between now and then, but assuming that rates remain near current levels, we don’t see much benefit in having net leverage below a range of 4 to 5 times and we’d pursue attractive acquisitions or share repurchases in order to be within that targeted range.

In summary, we delivered our strategic goals during the quarter and achieved financial results in line with our outlook. I’m confident that we have made, and will continue to make, smart investments in our future.

We’re well positioned with a strong integrated business model in building leading positions through our hospitals, USPI and Conifer. I’m very excited about the opportunities to drive growth across these three business lines in coming years and to improve margins in free cash flows and drive sustainable value for our shareholders over the long-term.

With that, let me turn the call over to Dan Cancelmi.

Daniel Cancelmi (CFO):

Thank you, Trevor. Good morning, everybody. There are several points that I would like to start with today about our results for the quarter.

We generated EBITDA that was within our guidance range. EBITDA was $566 million in the quarter, representing an increase of 23% and a 110 basis point improvement in our margin.

We are aiming the midpoint of adjusted free cash flow outlook by $100 million as a result of another strong quarter of cash flow performance. This is the second time this year we have raised our cash flow outlook. Last quarter we increased it by $75 million.
We drove admissions growth in our higher acuity, higher margin service lines, however our total admissions were impacted by declines in certain lower acuity business. Over a longer time horizon, we continue to believe that our strategies will produce admissions and adjusted admissions growth. Charity and uninsured admissions increased 3.7% in the quarter, primarily driven by higher numbers of uninsured patients in Florida and Texas.

Our Conifer services business delivered another strong quarter with EBITDA up 30%. Our outpatient businesses continued to drive strong results. Our ambulatory care cases increased by an impressive 6.3% and our hospitals achieved a healthy 3% increase in outpatient visits. Finally, our cost management efforts remain effective, including a year-over-year reduction in contract labor.

Now, let's spend more time discussing our results. As you can see on slide five, our hospitals reported a 0.6% decline in same hospital admissions, which was around 100 basis points below our expectations. Our initiatives and investments to expand key high acuity service lines continue to drive growth, however certain of our lower acuity business, namely behavioral health and respiratory volume, was softer than we anticipated in the quarter.

Also, we generated hospital surgery growth of 0.8% and grew our emergency department volumes 1.5%. We generated same hospital patient revenue growth of 6.5%, which was primarily driven by a 5.8% increase in revenue per adjusted admission. We continue to drive growth in higher acuity service lines and our case mix increased 1.4% in the quarter. And the California provider fee program increased our same hospital revenue by $41 million, which drove our revenue per adjusted admission up by 110 basis points in the quarter.

Keep in mind for modeling purposes, that we recorded $150 million of same hospital California provider fee revenue in Q4 last year, since CMS did not approve the program until then. In this year's fourth quarter, we anticipate recognizing $41 million of revenue. Our operators continue to manage expenses well. On a total hospital basis, our cost per adjusted admission increased 3% in the quarter and 1.9% year to date.

Our previous full year 2015 cost guidance was a range of 2% to 3%. As a result of our performance this year, we are now reducing our full-year cost outlook to a range of 2% to 2.5%.

We continue to identify and realize cost efficiencies and acquisition synergies across our various business units. In particular, our teams have been very successful realizing synergies related to the Vanguard acquisition. We expect to exit 2015 on a $200 million annual run rate, which was the high end of our initial estimate. And, we anticipate cash for any additional synergies in the future.

I want to the point out that our contract labor declined 15% in the third quarter on a same-hospital per adjusted admission basis. While we did experience pressure from contract labor last year, our teams have been very focused on reducing these costs and improving the balance between employee care providers and contract labor. We are clearly realizing benefits from these efforts as our contract labor costs declined for the fourth consecutive quarter.

Pharmaceutical costs have been a source of pressure over the last few years, with drug manufacturers pushing through large increases. This quarter, our pharmacy expense increased by approximately 13%. This alone accounts for roughly half for the 4.3% same hospital growth we reported for supply expense per adjusted admission in the quarter.

We have various initiatives in place to mitigate some of these increases, including product substitutions, formulary optimization, SKU reductions, strategic buying and reducing waste. Also, we anticipate generating additional efficiencies in pharmacy and other supply spend when we in-source our group purchasing function and transition to our recently announced group purchasing arrangement with HPG.
Bad debt expense was 7.3% of revenue in the quarter, which was consistent with our performance in the first half of the year. Slide 6 summarizes our uncompensated care trends over the past several years. We have added to the slide the discounts that we offer to uninsured patients through our compact with uninsured patients. I think you will find the additional information helpful because our uncompensated care can move back and forth among these three lines, depending on how a patient is ultimately classified.

This quarter our uncompensated care, as a percent of adjusted revenue, was 21.7%, which is up 80 basis points year-over-year. The increase is due in large part to a $28 million positive adjustment last year related to estimated future recoveries of patient balances after insurance payment. However, I’ll note that this ratio has been fairly stable over the past four quarters.

Turning to slide seven, our ambulatory segments case growth was very strong, increasing 6.3%. Revenue per case also increased 3.5%, resulting in 10.1% growth in same facilities system wide revenue.

For anyone not familiar with USPI’s historical financial reporting, the system wide growth shown on the slide includes the case of perform to consolidated and unconsolidated centers. This provides a better overview of volume performance across the entire portfolio.

On slide eight, you will see that our ambulatory segment generated 17% year-over-year EBITDA growth. The results at USPI and Aspen have been consistent with our expectations. Given the attractive economics of this business, combined with their consumer friendly nature, we’ll continue growing these care settings, both organically and through acquisitions.

I want to remind everyone that USPI operates surgery centers that bill the Medicare program as free-standing surgery centers, not as hospital out-patient departments. And it was never our intention to convert any of the centers into hospital-based outpatient departments. As a result, we do not foresee any exposure for USPI to the provision in bipartisan budget act related to the prospective site-neutral payment methodology. As patients, employers and insurers continue to focus on lowering their spend, USPI is well positioned as a patient-friendly, cost effective, high quality provider.

Conifer delivered another great quarter of year-over-year growth, with EBITDA increasing 30% to $61 million. This continues the trend of impressive growth in recent years, which is summarized on slide nine.

As we discussed last quarter, Conifer remains on track to meet or slightly exceed $260 million of EBITDA this year. Our free cash flow is very strong in the third quarter.

Adjusted net cash provided by operating activities was $563 million, up from $256 million in the same period last year. Key drivers of this growth include accounts receivable performance improvement by our Conifer team, our strong cash flow generating USPI business and additional leads of supplemental Medicaid funds from various states, including the California provider fee program. After subtracting capital expenditures, we generated $356 million of adjusted free cash flow in the quarter.

As a result of our cash flow results the past two quarters, we are raising the midpoint of the 2015 adjusted free cash flow by $100 million to a new range of $350 million to $500 million. As I mentioned earlier, this is the second time this year that we’re raising our outlook for adjusted free cash flow. Last quarter we raised our expectations by $75 million. Slide 10 provides additional details on the updated outlook for 2015.

In short, we are maintaining the midpoint of our range of adjusted EBITDA and tightening the range. As summarized on slide 11, we are reiterating the same pro forma view of 2015 that we provided in August and added a few more details that we thought you would find helpful for modeling purposes. The goal of
this pro forma information is to give you a starting point for modeling purposes of our numbers once all the previously announced acquisitions and divestitures are completed.

In summary, we effectively managed through a softer than expected inpatient volume environment and delivered EBITDA that was within our outlook range. Expense management continued to be a key area of focus and was an important contributor to our results in the quarter. And, our Conifer and ambulatory care businesses continued to deliver strong growth.

As a result of our performance this year, we are maintaining the midpoint of our full year adjusted EBITDA outlook and raising our outlook for adjusted free cash throw by $100 million. And we have announced the authorisation to deploy up to $500 million of capital on share repurchases through the end of next year.

I'll now asked operator to assemble the queue for our Q and A session. Operator?

QUESTIONS & ANSWERS

Operator:

Thank you, sir. (Operator Instructions) And we'll take our first question today from Ralph Giacobbe with Citi.

**Ralph Giacobbe (Analyst - Credit Suisse):**

I guess to the target leverage amounts, the first question is, does it include the $1 billion in proceeds?

**Daniel Cancelmi (CFO):**

Yes.

**Trevor Fetter (President & CEO):**

Ralph, this is Trevor, let me. I think we have gotten a lot of questions around these things. Let me open up and I'll let Dan add to it. This is not intended to be guidance.

This is intended to express our strategy about how we think about leverage going forward. It does include everything that we are aware of in the way of transactions, proceeds, borrowing, you know, paying distributions to minority partners, et cetera.

**Daniel Cancelmi (CFO):**

Good morning, Ralph.

Yes, that's right. The view is, of 2015, on a pro forma basis, as if all the acquisitions and divestitures have occurred as of the beginning of the year, so think of the $2.3 billion as a starting point that we'll grow from. Certainly, as we move through next year, we're going to continue to generate growth in our USPI business, Conifer continues to drive attractive growth. We anticipate were going to continue to drive growth in our hospital segment.

The other elements to consider in that pro forma view, is that does not reflect the improvement in the operations and synergies that we'll capture related to the Tucson and Baptist Birmingham assets that we acquired. We continue to drive additional costs efficiencies and we'll be able to capture more next year, as well as the fact that when we transition to our new group purchasing arrangement with HPG next year, in the early part of the first quarter, that's also going to drive additional efficiencies for us.

Again, a lot of growth that we see as a starting point from that baseline in 2015 and $2.3 billion.
Ralph Giacobbe (Analyst - Credit Suisse):

Okay. That's helpful.

On the NCI, can you help us think about, you know, sort of a cash versus noncash portion of that line and, you know, what is sort of the noncash piece? Like the out-flow for CHI and even on the USPI, I think there's sort of a cash versus noncash piece. Can you just remind us the components of that and why that is in terms of the noncash?

Daniel Cancelmi (CFO):

Yes. The noncash piece is roughly, you know, 35% to 40% of that number, Ralph, and that's the Welsh Carson component as well as the Catholic Health.

Ralph Giacobbe (Analyst - Credit Suisse):

And by not, I guess I'm just trying to get a sense of why is that noncash? Is there some adjustment that's made sort of on the balance sheet to help us think through why that is a noncash portion? Is there some sort of catch up ultimate that needs to be made and the liabilities essentially set up on the balance sheet?

Daniel Cancelmi (CFO):

Well, as far as the Catholic Health interest we're not making any distributions to them and as far as the Welsh Carson piece, we'll buy the remaining 49% of USPI over the next five years and that's on the balance sheet.

Ralph Giacobbe (Analyst - Credit Suisse):

Okay. Thank you.

Operator:

And we'll take our next question from Whit Mayo with Robert Baird.

Whit Mayo (Analyst - Robert W. Baird):

Thanks. Just to maybe start with the free cash flow guidance.

Obviously, the raise is mostly from lower CapEx and were there any projects that, you know, push out into 2016? Just any context around capital spending priorities to kind of frame up our expectations for what you might need to spend in the next year? Thanks.

Daniel Cancelmi (CFO):

Good morning, Whit. This is Dan.

We have certainly played with our cash flow performance in the quarter and so far this year, and as I mentioned in the prepared remarks, this is the second time that we have increased our cash flow guidance. Conifer is on drive and nice in performance improvement on the receivable side. Certainly the USPI business is great cash flow generating business and we have started to get a little bit more money in from some of the larger state Medicaid programs. So, now we think we have reached an inflection point where we can continue to drive growth and free cash flow.

We're very focused on driving improved free cash flow and when we look at, you know, the capital allocation opportunities available to us, we think, at this time, it was appropriate to reduce our estimate
for capital spend this year, and we obviously are not talking about 2016 yet, but we think that obviously we're going to continue to drive growth and free cash flow.

Whit Mayo (Analyst - Robert W. Baird):

Okay. I guess I'm just kind of curious, if we go back to January when you set your original plan, you know, what's fundamentally different in terms of some of the spending priorities versus today. I don't think I've ever seen anyone really blow through their CapEx numbers ending the year but does any of this just get delayed into 2016?

Daniel Cancelmi (CFO):

Listen, we, when we think about some of the investment opportunities we, you know, we have made a decision that, given our focus on free cash flow, we think this spend, that we're targeting for this year is appropriate at this point.

I wouldn't say there was any significant projects that's been pushed out that will impact, you know, 2016 significantly. So it's where we think we're at this point from an investment perspective.

Whit Mayo (Analyst - Robert W. Baird):

Okay. My second question's just around the ambulatory segment, obviously, a pretty impressive third quarter and when I look at, you know, USPI's performance in the fourth quarter of last year, it was exceptionally strong, as well.

Is there just anything unusual to call out as we think about the year-over-year growth as we enter the fourth quarter? I understand that there's a very strong pattern seasonal pattern that develops within the fourth quarter and probably have been, you know, growing over time, so I just want to make sure that we're all thinking through what the right growth rate is going forward.

Trevor Fetter (President & CEO):

Thanks. We have Bill Wilcox and Jason Cagle from USPI here and they'll take that question.

William Wilcox (CEO):

Okay. Hello Whit. We were probably as surprised as anybody on the strength of the revenue growth in the quarter and I think a better way to look at it long-term is in the 5% to 6% range with about half volume and half revenue. There's a big seasonality component to our business which is, has come over the last five years, as we're seeing changes in the way patients are involved in the decision-making processes.

And I think, we'll see that again this year, roughly a third of our earnings come in the fourth quarter and we expect that again. Some of the reasons that we think we're enjoying such good success right now are there's both a combination of market drivers and USPI specific drivers. So the market drivers that are giving us nice tail end, continued recognition of the benefits of ambulatory based surgical programs, both from a clinical and a payer perspective, and we're seeing continued demise of the out-of-network business and that's, I think, driving business to the in-network providers.

And then on the USPI side, I think we're doing a better job of keeping our doctors and earnings supportive of new doctors as well as some turn-arounds and then some big wins on a, at a few facilities that are moving their needle. Does that address your question?

Whit Mayo (Analyst - Robert W. Baird):
Yes. That's great, Bill. Thanks.

Operator:

We'll take our next question from A.J. Rice with UBS.

A.J. Rice (Analyst - UBS):

Hello, everybody, and thanks for taking my question. First off, I would just ask, on page 14 in your appendix, you have a number of items related to Q3 that you're highlighting. You mentioned a couple but you didn't mention others in the prepared remarks, can you expand a little bit on what was behind those? And then also, whether there is any lingering effects into the fourth quarter from those?

Daniel Cancelmi (CFO):

Good morning, A.J. This is Dan. Let me address that, there's a couple of points in there.

So, with the business disruption at our Desert Regional facility in Palm Springs, certainly one of our largest facilities, a lot of the various patient care units were essentially closed for an extended period of time, the hospital is on diversion so the ED volume was being redirected and various Med-Surg units, trauma unit, you know, it had a noteworthy impact on the quarter and we're still working through the insurance claim but we think that's behind us.

The hospital is fully operational, so we're past that. In terms of the interest rate impact, we put on the slide, you know, the seven-year rate went down 32 basis points so that impacts our estimate of our discounted malpractice liabilities.

There was some discussion, I saw, in some of the reports that it was additional malpractice reserves. It really just, we discount the liabilities so when the interest rates move it has an impact. In this quarter we had recorded $7 million of additional expense.

A.J. Rice (Analyst - UBS):

Okay. And then maybe one big picture question.

So, we're coming in at the end of our second year with the health reform benefits flowing through, I wonder if you guys could give us your perspective on where we're at, you know, relative perhaps to where you thought we'd be in terms of the benefit the reform might represent to you, say, in this spring or summer of 2013 versus today and then how do you think about how you are going to realize the rest of that benefit over time?

Trevor Fetter (President & CEO):

Okay, A.J., it's Trevor. I think, let's just, breaking it down a bit.

So I think on the, let's start with the exchanges. We, two years ago, anticipated, we thought the exchanges would provide a great opportunity for us, and I'm sure remember all of that drama about, what the pricing is going to be? Is it Medicaid? Is it going to be commercial? Whatever. Sitting here today, our exchange pricing is with 1% of commercial, which is what we expected. So, it's been a great product for us.

We continue to drive substantial gains in volumes in this quarter, it was 53% in the exchange volumes, and I think those are well established now as a marketplace for individuals to buy insurance. And as I mentioned in my prepared remarks, one of our strategies has been to have very attractive offerings on those exchanges that include our hospitals and, you know, we hit a record high of 90% of our hospitals
being in the lowest cost Silver Plan networks, so we are well-positioned on exchanges to continue benefiting from whatever growth there is.

You can debate it, you can look at different data sources for what the exchange enrollment is going to be, but whatever it is, we're well-positioned to benefit from it. On Medicaid, that's disappointing, I'm disappointed that we're sitting here in 2015 and will still don't have Texas and Florida, and we don't have, you know, really sort of any progress from a political point of view in moving those states towards expansion.

Of course, from time to time we'll hear positive things and we'll see it, we'll influence it coming out of state legislatures, most recently in Alabama, but you know, the big ones for us are Florida and Texas and we'll continue to wait. We do have plenty of constituents in those states to understand that Medicaid expansion would be good for business and good for the people in the state and we just, I think, have to be patient that, that provides upside, if you want to look at the glass as half full.

And otherwise, we have gotten all the cuts that we bargained for. And you know, on that basis it's probably exactly what we expected. But I would prefer to look at what we see as the well-positioned nature of our hospitals on the exchanges and the potential upside from expansion in future states as continuing opportunities for us.

A.J. Rice (Analyst - UBS):

Okay. Great. Thank s a lot.

Operator:

And we'll take our next question from Sheryl Skolnick with Mizuho.

Sheryl Skolnick (Analyst - Mizuho Securities):

Thank you very much. This was a very, very nice report in somewhat challenging circumstances, especially the issue with Desert Regional so congratulations to everyone. My question is going to try to link your guidance on CapEx, your commentary on leverage, the share repurchase and a conversation about expected returns because I really want to understand the thought process. My sense is that there's a high level of discomfort with the announced buy back and I'm not sure that I understood the explanation, other than to say it's to be flexible, and I think there's something more thoughtful behind it.

So I'm going to ask it this way, if I can. So, as I understand it, you would make this decision, yes, you want flexibility but also there's an expected return to holders from that buy back and presumably you've judged that the return to the holders from that buyback is at least equal to the alternative uses of capital including the repayment of debt and running at a fairly high 6% plus leverage at the moment. So, I'm trying to understand what you think the expended return of the buyback is. I'm concerned about reducing CapEx at a time when you have just acquired, through joint ventures, some pretty significant assets that may in fact require investment. I understand that you've got some pretty significant capital requirements, not just to buy back, to buy the rest of USPI over time, but to facilitate the strategic plan of continued development and acquisition there.

So, I'm trying to understand how all of these competing uses of capital rank in the order of return on that, not only to the company, to the shareholder, because when you got 8% coupon debt out there, it concerns me that we're not seeing more de-leveraging as part of this otherwise well-balanced strategy. I would love your view on it.

Trevor Fetter (President & CEO):
Why don't we -- Let me start with CapEx because I want to take off the table a notion that we are somehow cutting back on CapEx. At virtually every point in time for the last 12 years, we have had at least one or more new hospitals under construction. We have, at this time, one new hospital under construction and it will near completion next year.

So a part of our anticipated ability to reduce capital spending is on very large ticket projects. I mentioned in my script, that for the time being we'd be passing on the opportunity to build new hospitals or really substantial new patient towers. And I think in an industry that changes rapidly, as this one does from the time you start a big capital project, like a new hospital, to the time you generate your first dollar is typically about five years. That's a long time to be out there with a very significant project where the needs change along the way.

So I think in this volatile environment, Sheryl, as long as we're in a situation where our stock has been hit so badly and enterprise values of hospital companies have been hit as much as they have, that it's just prudent to back off on some of the very long-term, long dated, very expensive capital projects. The same would go for turn-around acquisitions that involve substantial capital commitment, no greater example of that than Detroit, where we are nearing completion of the capital commitment that we had engaged in, by the way those have yielded good results. Once, again, three of our fastest growing hospitals in the quarter were in Detroit, from an admissions point of view. So we're nearing a natural completion of some of this heavy capital spending that should enable us to remain competitive, invest appropriately in the facilities we have and I just want to take this CapEx, you know, cut notion off.

As far as the returns question, if we were having this conversation at our last quarterly call, as I mentioned, we'd be looking at an opportunity to invest nearly $800 million in calling those 8% notes that aren't due until 2020, that would have a certain return, as of that call price of 6% and our stock has returned nearly 20% just in the last week and a half. We just are comparing those alternatives, it just seems like right now is not a great time to be investing in the repayment of debt.

The change to our leverage ratio is pretty immaterial, 0.2 turns, and we think that having the flexibility to this, particularly, you know, we are very aware of the very material change in our stock price just in the last couple of months, really on no fundamentals at all, more on fear and on, you know, re-valuation of hospital companies which, by the way on an enterprise value we've been hit less than our peers, but because of the leverage we've been hit more. The leverage works the same way on the way up and that's where we expect to be. We're expressing confidence in our future and think that the among other things, is a great investment and we're not doing at the exclusion of other investments that we'll make in our businesses.

Sheryl Skolnick (Analyst - Mizuho Securities):

Fair enough. Thank you.

Operator:

And we'll take our next question from Josh Raskin with Barclays.

Josh Raskin (Analyst - Barclays Capital):

Hello. Thanks. The first question on the USPI side. I think, Bill, you mentioned a 5% to 6% sort of long-term same store growth but more interested in how do we think about the inorganic growth and what do you think is a reasonable center count growth in the future? And can USPI, can the JV sort of self-sustain that or will that need capital to do so?

William Wilcox (CEO):
Right, Josh. Well, I think that we have a very robust pipeline, both, for acquisitions of ASCs and surgical hospitals. And, we also enjoy a nice cash flow, so historically, and it varies a lot from year to year, but historically we've deployed about $150 million in capital each year and we've got free cash flow of about that same amount. So I think hopefully we'll have even more success than $150 million and, if so, we would go beyond our free cash flow, but you know, everything that we, or most everything, that we buy with be cash generated so I think we're in good shape there.

Josh Raskin (Analyst - Barclays Capital):

And, Bill, just remind me, when you guys --

William Wilcox (CEO):

Oh, I'm sorry.

Josh Raskin (Analyst - Barclays Capital):

Sure.

William Wilcox (CEO):

I'm sorry. I didn't answer your question. You had asked in terms of number of facilities, and really we don't look at it that way because there's such a huge variation in size of what we acquire.

Josh Raskin (Analyst - Barclays Capital):

Okay. And then just as a reminder, you guys typically, you ramp up those new centers, they typically run company average margins within about a year, right? It's pretty quick, as I remember.

William Wilcox (CEO):

Yes, a year, year and a half.

Josh Raskin (Analyst - Barclays Capital):

And then, a second question, just on Conifer now, I think, Dan, last quarter you'd said that the fourth quarter would be a little bit stronger than the third quarter. I think you mentioned you could do a little bit more than the $260 million this year, so just want to confirm, is Q4 expected to be up sequentially or did something move into Q3. And then I think you'd previously mentioned some investment spending in Conifer, that was, you know, impacting the EBITDA and I'm just curious, how much of that investment spending does not recur next year?

Daniel Cancelmi (CFO):

Conifer had another good quarter and we were really maintaining our outlook for the full year for Conifer, of at least $260 million, maybe a little bit more. So nothing has really changed.

In terms of our investment over the past several quarters, that we talked about, it was, one of the items was ensuring that ICD-10 implementation went very well, not only for Tenet but for other customers of Conifer. So we've making some investments to ensure that has been successful and so far it has been. We'll continue to have a little bit of spend in the fourth quarter on that, as well.

Again, I would say we're going to ultimately deliver this year at least $260 million, maybe a little bit more for Conifer, for the EBITDA.

Josh Raskin (Analyst - Barclays Capital):
But no way to quantify what that sort of incremental spend is that doesn't recur next year?

Daniel Cancelmi (CFO):

In terms of 2016, we'll talk about that when we go out with our guidance next year, in terms of what type of investments we'll be making on the Conifer side.

Josh Raskin (Analyst - Barclays Capital):

Okay. Thanks, Dan.

Operator:

And we'll take our next question from Kevin Fischbeck of Bank of America Merrill Lynch

Kevin Fischbeck (Analyst - BofA Merrill Lynch):

Okay, great. I just want to clarify one thing about this free cash flow guidance, is there anything unusual this year or is this both a cash flow and a CapEx, are these both good numbers to think about as we build our models going forward?

Trevor Fetter (President & CEO):

Good morning. In terms of, as far as modeling cash flow going forward, we'd certainly think we're going to grow from here, from our free cash flow that we're targeting in 2015, so we think we can grow that into the future. We'll certainly provide more visibility regarding our investments that we anticipate making next year, getting back to the capital spend.

We do have several new platforms coming, that have come on board in Birmingham and Tucson. And so we'll obviously take that into consideration and, you know, looking beyond the growth in the USPI business, that's going to continue to generate strong free cash flow. You know, and on the hospital business, Conifer is doing a good job in terms of AR management so we think we'll be able to continue to grow free cash flow next year.

In terms of your point, or question, about was there anything unusual, I wouldn't say it's unusual. We're finally getting a little bit of money in from these large state supplemental Medicaid funding programs, so we've got a little bit more money this year compared to last year but, you know, those numbers, they can move around a little bit, but we're obviously pleased with what we've been able to drive so far this year.

Kevin Fischbeck (Analyst - BofA Merrill Lynch):

This is the other question, would be on the cost side because that was one thing that seemed to pressure a lot of your peers and it didn't impact you this quarter in the same way.

And, I appreciate the comment that you guys obviously have a company specific dynamic around synergies coming through Vanguard and if you didn't have Vanguard synergies outperforming, would you still have been able to bring that number down because it seems like a pretty good result, given the context of the commentary you made about growing high acuity volume, which I would have thought (inaudible), increased adjusted admissions costs.

Trevor Fetter (President & CEO):

This is Trevor. I wanted to ask Britt to comment on labor management because if this is these problems that you've heard about on contract labor and so forth that were not evident for us in our quarter. We had those problems earlier in the year and even in the last half of last quarter but I think our operators
did a great job managing labor in the quarter. You want to speak to that, Britt?

**Britt Reynolds** (President of Hospital Operations):

Absolutely, Trevor. And good morning, Kevin. As Trevor alluded, we saw record volume in 2014 and at times were challenged to match the labor with that and use a lot of expensive overtime premium. What I'm really proud of our operators on is we've stepped through the first half of this year, we've continued to have robust volume and then, as we've alluded and commented on, we had a drop on the in-patient side in the third quarter.

We don't talk much about the reasons today but what I'm really proud is, is that we have matched the staffing with the volume throughout the high periods and in the lower periods and more specifically, as you look at the hospital business, I'm really pleased with the contract labor being down, as Dan mentioned, 15% per adjusted admission, taking the volume into account, year over year, it slowed down sequentially from quarter to quarter, so this is something that we put in place a long time ago to make sure that we could be nimble in periods of up and down. And then the last comment I would make to that, and this gets a little more granular but I think you deserve to know that.

As you look at how we provide care, oftentimes we use our own internal folks on a premium labor basis, be it overtime or other aspects. Our overtime number in this quarter is down 6.5% per adjusted admission and our salaries and wages, specifically the salary and wages on the hospital segment, is down a little, just right at 1% or a little less, so when you look at all those productivity measures and matching staffing through volume, I'm really pleased with our operators.

**Kevin Fischbeck** (Analyst - BofA Merrill Lynch):

So you don't see any kind of broad-based labor waves pressure or anything like that in your markets?

**Britt Reynolds** (President of Hospital Operations):

I don't. And I think primarily for several reasons, but the most important being that this is something we have worked on with various aspects of our organization to look at how we're hiring folks, retaining folks, recruiting folks, orienting them, having them nimble, shifting more to a full-time employment, rather than using PRN or periodic staffs, so we think we're in a spot where we're nimble and I really don't see a challenge going forward.

**Kevin Fischbeck** (Analyst - BofA Merrill Lynch):

Okay, great. Thanks.

**Operator:**

And, we'll take our next question from Andrew Schenker with Morgan Stanley.

**Andrew Schenker** (Analyst - Morgan Stanley):

Thanks, good morning. Just for the high acuity case, I wonder if you could provide a little bit more color there. You mentioned the investments in key specialty areas, so should we interpret that really as you're gaining share or you're also seeing maybe better commercial mix or more elective procedures, anything else supporting those high acuity cases.

**Britt Reynolds** (President of Hospital Operations):

Good morning, Andrew. This is Britt. You've heard us on many conference calls going back several quarters, and actually years, where we have invested in the high acuity in-patient surgical oriented
programs, and that's technology, that's physicians, that's training of our staff and that's breadth of the service offerings.

Those are particularly in neurosurgery, very much so in orthopedics and all the aspects of orthopedics, including spines, joint work and complex ortho procedures, surgical on the infectious disease which was a high utilization particularly in this quarter and then also on the nonsurgical side, where it's very important in certain marketplaces, on the neonatal intensive care units, we have seen growth. So those are all places where deployed capital, time, attention and efforts to grow that business and we have seen that and we continue to see that.

As you look at our volume in this quarter, and Dan alluded to this earlier, we had low acuity drop-offs in behavioral and pulmonary disease. And the pulmonary disease was very understandable compared to the earlier onset of flu and respiratory last year, pretty atypical in the third quarter in the industry. So, what we've seen is higher growth in acuity and we attribute that to effort, focus, moving market share, recruiting high-profile physicians where necessary and really just focusing and doubling down our operators

Andrew Schenker (Analyst - Morgan Stanley):

Okay, great. And then just real quick, you highlighted the uninsured admission increases in Florida and Texas. Can you maybe just talk about what is happening in those markets? Is it a change in the economy, people dropping off the exchanges, anything worth highlighting there?

Daniel Cancelmi (CFO):

Good morning, Andrew. This is Dan.

So, when we looked at our trends in those particular markets, in aggregate, let me just frame everything here, so our uninsured volumes were up slightly by 3.7% across the entire portfolio, which is a little less than 400 admissions, and year to date obviously the aggregate population of those patients we have been servicing has actually declined as we talked about throughout the year. In those two markets, we did see an uptick in the third quarter. We don't think it's, as Trevor pointed out in his remarks, we feel very confident about what we can generate in terms of additional growth from exchange patients, as well as some growth in Medicaid expansion states, so there's nothing in particular that we saw that would, that seems like a trend that we are overly concerned about.

Britt Reynolds (President of Hospital Operations):

Andrew, this is Britt. I would simply add to that, in Texas and Florida, as Trevor alluded earlier, we saw, overall, about a 50% increase in exchanges and in Texas and Florida they were materially higher on the exchange growth in those states so we're definitely not seeing any degradation of the exchange in those key areas.

Andrew Schenker (Analyst - Morgan Stanley):

Great. Thank you.

Operator:

And, gentlemen, I'll turn the call back over to you for any additional or closing remarks.

Trevor Fetter (President & CEO):

Okay, thank you, operator. We just want to be sensitive to the fact that there's another company with a call beginning in a minute here. So thanks to everybody. We'll see you on the next call in February.